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A $15 minimum wage changes more than just take-home pay

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Does a rise in the minimum wage lead to higher unemployment? Economists have been arguing this question for a long time, and the “fight for $15” movement has really heated up the debate on how a higher minimum wage changes employment. According to the basic economics 101 explanation, an increase in the minimum wage motivates more people to enter the labor market because they will earn more money. At the same time, an increase in the minimum wage increases firms’ costs and the quantity of labor demanded decreases (firms hire fewer workers). Now more people are looking for work than there are jobs available, which leads to unemployment. Although some economists believe this explanation, several studies have found that an increase in the minimum wage changes employment little, if at all.

In his article “How do firms respond to minimum wage increases? Understanding the relevance of non-employment margins” (*Journal of Economic Perspectives,* Winter 2021), economist Jeffrey Clemens argues that focusing only on how a minimum wage affects employment is a mistake. Clemens explores nonwage aspects of a job (health insurance, working conditions, schedule flexibility, and production technology) that a firm might adjust in response to higher costs caused by a minimum wage increase. In his article, he reviews the findings of existing studies that have examined these nonwage aspects of the job, and he offers his opinion on how policy makers should use this information to assess using the minimum wage as a tool to improve worker welfare. Clemens highlights the lack of empirical evidence in many of the areas he discusses and the need for more research.

An increase in the minimum wage increases firms’ costs and lowers their profits. Firms often try to pass that cost through to the consumer in the form of higher prices for their products. Some goods are made to be consumed where they are purchased, and others have no viable substitutes—haircuts, restaurant meals, electricity, water, and construction. Firms can raise the price of these goods and pass the minimum wage-related extra costs on to the consumer. Clemens also cites a study that argues that minimum wage hikes can be regressive because a large proportion of low-income households’ budgets go toward products and services made by minimum wage workers, such as restaurants. He even cites the 2019 Consumer Expenditure Survey to show that food (both at and away from home) accounts for 15 percent of the budget of low-income homes but only 10 percent of the budget of high-income homes. All of this means that the increase in the income of those receiving the minimum wage is thus smaller than it was intended to be.

Other ways that firms can adjust to minimum wage increases is by making noncash benefits (such as pensions, health insurance, and paid leave) less generous. With a higher minimum wage, health insurance may become less generous for all employees, even the higher skilled employees not directly affected by the minimum wage. From their perspective, they would be worse off than before.

Facing increased labor costs, firms may buy cheaper office equipment or offer fewer training opportunities. Firms may also replace lower skilled, less-educated workers with higher skilled, more educated workers. If firms were to hire a greater number of high-skilled workers, low-skilled workers would have more difficulty finding work. Firms might also have the option to replace people with technology.

Although many studies do not find that an increase in the minimum wage causes a rise in unemployment, Clemens argues those studies do not use models that are sufficient to capture other changes in social welfare that an increase in the minimum wage might cause. To compensate for their loss of profit due to their rising labor costs, firms might manipulate many nonwage aspects of a job, such as less generous health insurance, pensions, and amenities; and replacement of lower skilled minimum wage earners with higher skilled workers or with technology.